Euro wrap-up

Overview

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- Bunds made very modest gains even as data for German factory orders and euro area retail sales beat expectations.
- Gilts made gains as the BoE left its asset purchase target unchanged while reducing its weekly pace of purchase, and revised up its GDP forecast while also expecting inflation to be close to target at the end of its projection horizon.
- Friday will bring IP and trade data from Germany and France and a construction survey from the UK.

Daily bond market movements

Bond	Yield	Change
BKO 0 03/23	-0.705	-0.003
OBL 0 04/26	-0.608	-0.001
DBR 0 02/31	-0.233	-0.004
UKT 0⅛ 01/23	0.026	-0.020
UKT 0⅛ 01/26	0.326	-0.028
UKT 4¾ 12/30	0.820	-0.031

*Change from close as at 4:30pm BST.
Source: Bloomberg

Euro area

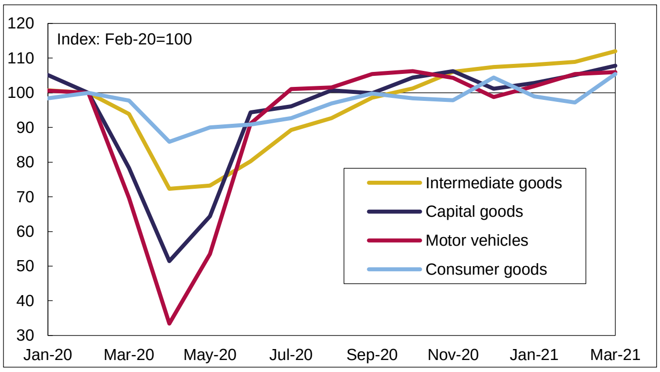
German new factory orders beat expectations to point to strong IP growth in Q2

German new factory orders in March beat expectations, rising 3.0%M/M in March, double the median forecast on the Bloomberg survey, following upwardly revised growth of 1.4%M/M in February. The upside 'surprise', however, was due to large-scale items, excluding which orders rose 1.6%M/M. While the annual growth rate (a whopping 27.8%Y/Y) was clearly flattered by base effects from the first wave of Covid-19 last spring, new factory orders were still up 9.1% to above the pre-pandemic level in February 2020. And following steady growth in January and February, they were up a strong 2.3%Q/Q in Q1. The pickup in demand was broad-based. Domestic orders were strongest in March, rising 4.9%M/M to be up 1.8%Q/Q in Q1. And orders from elsewhere in the euro area were up 0.7%M/M and 1.2%Q/Q while those from outside the euro area were up 2.2%M/M and 3.6%Q/Q. By type of good, orders of intermediate goods rose 2.8%M/M and 4.5%Q/Q, with those of capital goods up 2.5%M/M and 1.1%Q/Q, and consumer goods rebounding a vigorous 8.5%M/M to be up an admittedly modest 0.3%Q/Q. Electronic parts and devices saw particularly strong demand, up 5.4%M/M in March and 9.1%Q/Q in Q1. But orders of a range of items, from chemicals (5.3%M/M and 1.8%Q/Q) to cars (0.6%M/M and 1.3%Q/Q), were also firm. With manufacturing turnover up 2.0%M/M, tomorrow's German IP data for March should similarly confirm solid growth in production at the end of Q1, albeit leaving the level of output still below that ahead of the pandemic. Notwithstanding ongoing supply-chain strains related to semiconductors and low inventories of certain items, the orders data – like recent surveys such as those from the ifo institute – foreshadow strong expansion in manufacturing output in Q2.

Retail sales rebounded in March but quarterly pace of decline accelerated in Q1

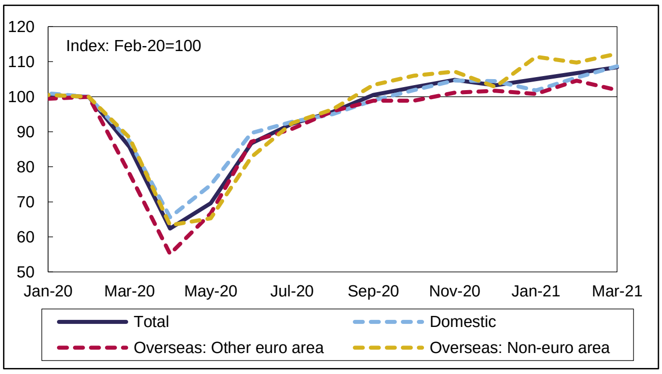
The euro area's retail sales figures for March also implied a strong end to Q1, with growth of 2.7%M/M following upwardly revised growth of 4.2%YM/M in February. Among the member states, growth was particularly strong in Germany (7.7%M/M), the Netherlands (8.4%M/M) and Spain (3.6%M/M), but sales dropped 1.0%M/M in France as pandemic restrictions were tightened. Given the sharp drop a year earlier at the start of the pandemic, sales in the euro area were up 12.0%Y/Y, but they were also 1.3% above the pre-pandemic level in February 2020. Nevertheless, due to the weakness at the start of the year, euro area sales were still down 2.1%Q/Q in Q1 following a drop of 1.0%Q/Q in Q4. Within the detail, sales of food, drinks and tobacco rose 1.0%M/M to be up 1.7%Q/Q. But sales of auto fuel fell 2.9%M/M to be unchanged on the quarter. And while sales of core items (neither food nor auto fuel) rose 4.6%M/M they fell 4.8%Q/Q in Q1 as a whole. And online and mail order sales rose a further 1.4%M/M to a new series high to be up 9.1%Q/Q. The persistence of restrictions into April in Germany and France, reflected in little improvement in mobility indicators, suggest modest further growth in sales this month

Germany: New factory orders by type of good



Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Germany: New factory orders by destination*



**Excludes large-scale orders. Source: Refinitiv and Daiwa Capital Markets Europe Ltd.*

in the largest two member states. However, with restrictions likely to be relaxed from this month on, we look for a return to growth over Q2 as a whole ahead of a firm rebound in Q3.

Construction activity appears stable in April, with Italian strength offsetting German weakness

According to Markit's construction PMIs, overall activity in the sector was stable in April with the headline index unchanged at 50.1. However, there were significant differences in conditions among the various member states. Consistent with solid growth in mortgage lending, the survey reported ongoing growth in house-building and at the firmest rate during the pandemic, led by record growth in Italy which more than offset weakness in Germany. It also reported a slowing in the pace of decline in commercial work in the sector at the softest pace in more than a year, again with growth in Italy helping to offset weakness in the euro area's largest member state. And despite a similar pickup in Italy, civil engineering output remained in retreat as infrastructure activity continued to decline in France as well as in Germany. Among the other detail, the amount of new business was stable. But firms continued to reduce headcount in the sector. Looking further ahead, Italian firms were the most upbeat in almost twenty years about the outlook for the coming twelve months. But German firms were once again pessimistic about the coming year and French firms were somewhat less upbeat.

The day ahead in the euro area

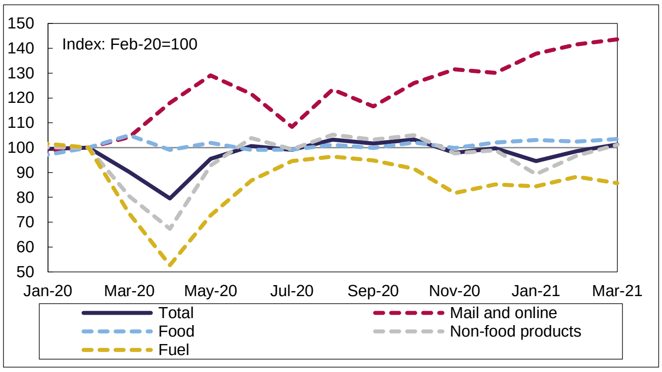
Looking ahead to tomorrow, March IP numbers from Germany, France and Spain will be released, as well as trade figures from Germany and France. Despite ongoing disruption to the supply of semiconductors, surveys and today's turnover data point to a firmer end to Q1 for manufacturers, with German IP likely to have risen by more than 2.0%M/M. Given weakness earlier in the quarter, however, that would leave IP down around 0.8%Q/Q in Q1. In France, industrial production is expected to rise 2.0%M/M in March, which would leave it flat on the quarter, while Spanish IP is expected to rise 0.5%M/M and 1.1%Q/Q. Meanwhile, ECB President Lagarde is due to speak publicly at an event in the morning.

UK

BoE leaves asset purchase target total and end-date unchanged but slows weekly pace of buying

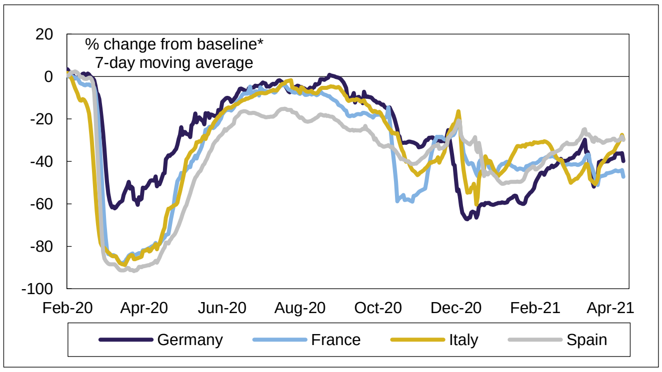
Following the conclusion of its latest MPC meeting, the BoE voted to leave unchanged its asset purchase target at £895bn, of which £815bn has so far been accumulated and £875bn would comprise of Gilts. It also agreed again that net purchases

Euro area: Retail sales



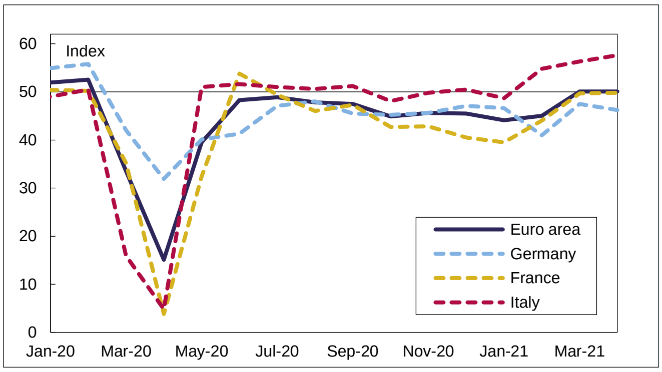
Source: Refinitiv and Daiwa Capital Markets Europe Ltd.

Euro area: Retail and recreational mobility



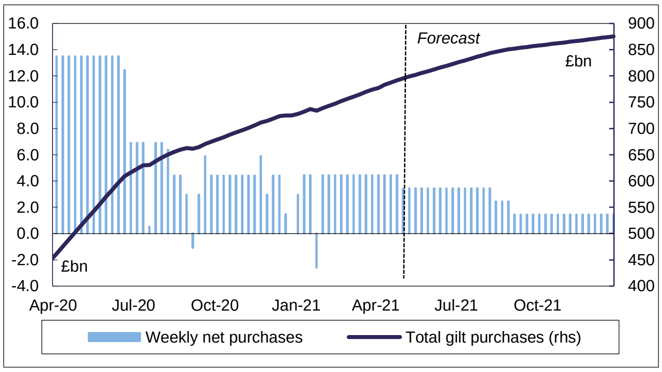
**The baseline is the median value, for the corresponding day of the week, during the five-week period 3 Jan – 6 Feb 2020. Source Google Mobility Report and Daiwa Capital Markets Europe Ltd.*

Euro area: Construction PMIs



Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: BoE's gilt purchases



Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

would continue to "around the end of 2021". However, one member of the Committee – Chief Economist Haldane, who will leave the MPC following the June meeting – voted to reduce the target of Gilt purchases by £50bn, and bring forward the date to August at which net bond purchases would be completed. In addition, the MPC agreed to slow the pace of its continuing purchases until the week commencing 2 August to £1.147bn per auction (about £3.4bn per week) from the previous rate of £1.48bn per auction (about £4.4bn per week). The Bank insisted that, as the eventual total stock of purchased assets would not change, and the BoE's policy (unlike that of the Fed) had not been one of open-ended QE, this decision should not be interpreted as a change in the stance of monetary policy, or indeed a first tapering. Indeed, it was considered to have no macroeconomic cause or effect whatsoever and merely reflected the fact that market functioning was judged now to be satisfactory.

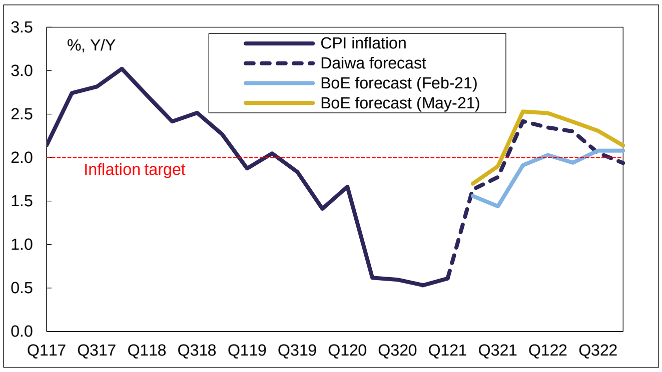
MPC expects much stronger growth this year with less long-term scarring than previously feared

As expected, the MPC revised up significantly its near-term GDP forecast. Indeed, it now thinks that economic output dropped about 1.6%Q/Q (very close to our own forecast) in Q1 compared to its previous forecast drop of 4.2%Q/Q. And consistent with recent survey indicators, such as the final April services and composite PMIs which were today revised up to 61.0 and 60.7 respectively, both more than seven-year highs, it forecasts a vigorous rebound from the current quarter. And it now thinks that the pre-Covid level of GDP will be surpassed by year-end. Among other things, the extension of the furlough scheme – which caused it to revise down its assessment of the peak in the unemployment rate to about 5½% in Q3 – and extra near-term fiscal policy support including the new business investment incentives, as well as the more favourable outlook for the pandemic, all justified the more upbeat near-term outlook for GDP. Based on a recent survey, the BoE also revised up (by 5ppts to 10%) its estimate of the share of excess household savings that will be spent over the coming three years. In particular, the BoE forecasts GDP to rise 7.25%Y/Y in 2021, compared to its previous expectation of growth of 5.0%Y/Y. Admittedly, it also thinks that growth will slow fairly abruptly by the middle of 2022, and so revised down its GDP growth forecast for next year by 1.5ppts to 5.75%Y/Y. Nevertheless, having revised down its estimate of the long-run economic 'scarring' from Covid-19, it now projects the level of GDP in 2023 to be 1% higher than it thought it would be back in February.

Inflation forecast revised up for this year, but tightening still unlikely before 2023

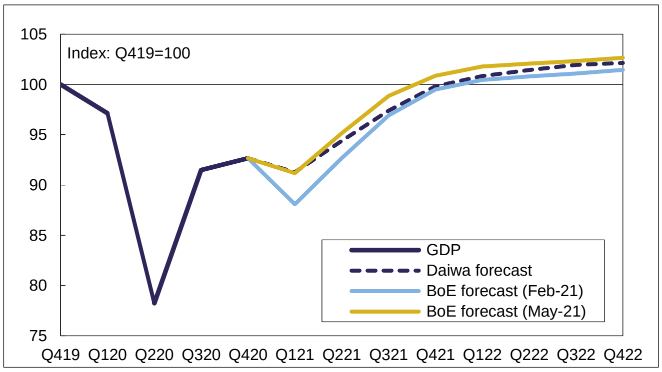
Coinciding with the stronger near-term GDP outlook, the BoE also revised up its outlook for inflation, which it now expects to peak at around 2.5%Y/Y in Q4. But it then expects inflation to edge gradually lower in 2022 to about 2.0%Y/Y at the end of next year. And, assuming the recent market-implied profile of a couple of hikes to Bank Rate by end-around 2023, it expects inflation to edge slightly below the 2.0%Y/Y target from mid-2023 to mid-2024.With an alternative assumption of unchanged

UK: Inflation forecasts



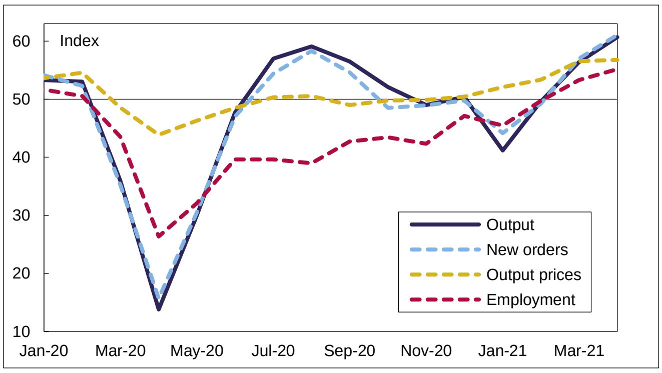
Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: GDP forecasts



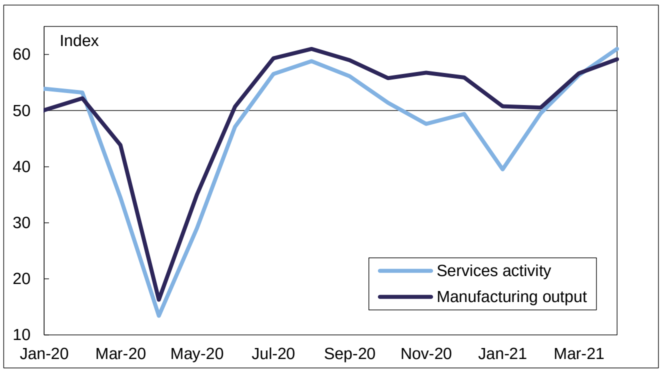
Source: BoE, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Composite PMI and components



Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

UK: Manufacturing and services PMIs



Source: Markit, Refinitiv and Daiwa Capital Markets Europe Ltd.

rates through to mid-2024, the BoE forecasts inflation to remain just 2.1%Y/Y at the end of the projection horizon, suggesting that the MPC currently sees need for little if any tightening over that period. Indeed, the tone of the minutes, and commentary of BoE Governor Bailey in his press conference – e.g. emphasizing that the upwardly revised GDP forecast still represents two lost years of growth – suggests that the BoE is not going to get carried away by the vigour of the rebound in economic activity or rise in inflation this year. Indeed, the MPC underscored that the strong GDP growth and “modestly” above-target inflation would be “temporary” and that it will “as always, focus on the medium-term prospects for inflation… rather than factors that are likely to be transient”. While it dropped the suggestion that policy might be eased once again, it repeated its forward guidance that it "does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably”. Overall, therefore, today’s information from the BoE encourages us to maintain our view that there is unlikely to be a rate hike from the BoE before 2023, and the pace of monetary tightening thereafter – when fiscal policy is set to be tightening significantly – is likely to be very gradual too.

The day ahead in the UK

UK financial markets tomorrow will take stock of the outcome of today’s elections to the Scottish Parliament, with a majority of seats likely to be won by supporters of independence, raising existential uncertainty about the future of the UK. It is touch and go whether the Scottish National Party (SNP) will win a majority in its own right. If not, it could seek a ruling coalition with pro-independence Green MSPs, rather than engaging with the new breakaway pro-independence Alba party of former SNP dissidents. Such a coalition would pressure the UK government to agree to a new referendum on Scottish independence, which opinion polls suggest now would find a majority in favour. In return, the UK government would likely insist that such a new plebiscite would have to wait at least until after the next UK general election, currently scheduled for 2024. A delay strategy, however, might only serve to fuel support for Scottish independence.

The week will end relatively quietly on the UK data front with only the construction PMIs scheduled for release. The headline activity index is expected to rise to a more than six-year high of 62.1 in April, from 61.7 previously. Together with the stronger-than-expected manufacturing and service sector PMIs, such an increase in the headline construction index would be indicative of a broad-based recovery as restrictions on activity are steadily eased.

European calendar

Today’s results

Economic data

Country	Release	Period	Actual	Market consensus/ *Daiwa forecast*	Previous	Revised
EMU	Construction PMI	Apr	**50.1**	-	50.1	-
	Retail sales M/M% (Y/Y%)	Mar	**2.7 (12.0)**	1.6 (9.4)	3.0 (-2.9)	**4.2 (5.8)**
Germany	Factory orders M/M% (Y/Y%)	Mar	**3.0 (27.8)**	1.5 (25.6)	1.2 (5.6)	**1.4 (5.8)**
	Construction PMI	Apr	**46.2**	-	47.5	-
France	Construction PMI	Apr	**49.8**	-	49.7	-
Italy	Construction PMI	Apr	**57.6**	-	56.3	-
UK	Final services (composite) PMI	Apr	**61.0 (60.7)**	60.1 (60.0)	56.3 (56.4)	-
	BoE Bank Rate %	May	**0.10**	*0.10*	0.10	-
	BoE Gilt purchase target £bn	May	**875**	*875*	875	-

Auctions

Country	Auction
France	sold €6.81bn of 0% 2031 bonds at an average yield of 0.13%
	sold €1.80bn of 0.5% 2040 bonds at an average yield of 0.62%
	sold €1.75bn of 0.75% 2052 bonds at an average yield of 0.93%
Spain	sold €1.33bn of 0% 2026 bonds at an average yield of -0.24%
	sold €1.94bn of 0.1% 2031 bonds at an average yield of 0.433%
	sold €1.66bn of 1% 2050 bonds at an average yield of 1.405%
	sold €509mn of 0.7% 2033 index-linked bonds at an average yield of -0.802%

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Tomorrow's releases

Economic data

Country		BST	Release	Period	Market consensus/ *Daiwa forecast*	Previous
Germany		07.00	Industrial production M/M% (Y/Y%)	Mar	2.0 (5.6)	-1.6 (-6.4)
		07.00	Trade balance €bn	Mar	20.0	18.2
France		07.00	Trade balance €bn	Mar	-	-5.2
		07.45	Industrial production M/M% (Y/Y%)	Mar	2.0 (15.2)	-4.7 (-6.6)
		07.45	Manufacturing production M/M% (Y/Y%)	Mar	-	-4.6 (-7.1)
Italy		09.00	Retail sales M/M% (Y/Y%)	Mar	-0.6 (-)	6.6 (-5.7)
Spain		08.00	Industrial production M/M% (Y/Y%)	Mar	0.5 (12.6)	0.0 (-2.1)
UK		09.30	Construction PMI	Apr	62.1	61.7
Auctions and events						
EMU		11.00	ECB President Lagarde scheduled to speak publicly			

Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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https://www.uk.daiwacm.com/ficc-research/recent-blogs